

Southeast Asia's New Institutional Architecture for Cooperation in Economics and Finance

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I. INTRODUCTION

In 1992, the member states of the Association of Southeast Asian Nations (ASEAN)¹ initiated the ASEAN Free Trade Area (AFTA), representing a clear break with the past when these governments had continuously rejected calls by the ASEAN business community and scholars to establish a free trade area for Southeast Asia. AFTA's adoption follows the 1989 establishment of the Asia Pacific Economic Cooperation (APEC) forum.² For the Southeast Asian states, these two institutional arrangements dominated the regional economic landscape for much of the 1990s. Nevertheless, APEC and AFTA stand in marked contrast to each other. While the former reflects a geographically dispersed trans-Pacific membership, AFTA reinforces a geographically concentrated Southeast Asian regional configuration defined by the membership of ASEAN. Interestingly, the Southeast Asian governments have adopted a more typical trade negotiation approach to AFTA that led to a higher degree of institutionalisation through the adoption of binding rules. In contrast, these same governments rejected institutionalisation in APEC and instead, advocated non-binding agreements and voluntary commitments.³ Following the completion of the first, tariff-reduction phase of AFTA in 2002, ASEAN adopted the ASEAN Economic Community project (AEC) in 2003 that aims to create an integrated Southeast Asian market by 2020 through a programme of deeper integration beyond the tariff reductions that were AFTA's main, though not sole, focus.

¹ The ten-member Association of Southeast Asian Nations was established in 1967 by Indonesia, Malaysia, the Philippines, Singapore, and Thailand, with Brunei joining in 1984, Vietnam in 1995, Laos and Myanmar in 1997 and Cambodia in 1999.

² Currently grouping 21 members, APEC was formed in 1989 as a ministerial-level meeting of 12 member countries, its original aim to provide an informal regional dialogue mechanism on trade matters.

³ Nesadurai (2004) p. 154.

The ASEAN Plus Three (APT) forum, on the other hand, brings together the ten members of ASEAN with three Northeast Asian countries – China, Japan, and South Korea – thereby reflecting a broader, *East Asian* as opposed to Asia-Pacific or Southeast Asian regionalism. Although the APT aspires to a comprehensive regional cooperation agenda that covers both trade and non-traditional security, the APT is, at present, best known for its projects in regional *financial* cooperation, especially the Chiang Mai Initiative (CMI) which took effect in May 2000. The CMI is a regional liquidity facility that offers the Southeast Asian states emergency financing to respond to speculative attacks on their currencies. The APT is also engaged in a project to develop regional bond markets. The East Asian Summit, held in Malaysia in December 2005, involves a slightly different membership from APT, with India, Australia and New Zealand also invited as participants. How the EAS will unfold remains unclear for the moment.

In addition to these broader East Asian institutional arrangements, a variety of other economic cooperation arrangements have also taken root in this part of the world. These include free trade areas (FTAs) that ASEAN as a grouping has negotiated, such as the ASEAN-China Free Trade Area (ACFTA), or is in the process of negotiating (such as with Japan, South Korea, India and the Australia-New Zealand grouping). There has also been a mushrooming of bilateral FTAs negotiated between individual ASEAN members with non-Southeast Asian countries, with Singapore the most active proponent of the bilateral instrument and Thailand fast approaching Singapore's fervour for bilateralism.

The wide variety of institutional arrangements involving the Southeast Asian countries, each with its own distinctive agenda, membership and modality of cooperation raises a number of questions that constitute the focus of this paper. First, and most fundamental, is the question of

why the Southeast Asian countries have adopted such a variety of institutional arrangements to govern their economic relations. Other questions inevitably follow from this. Why have these governments privileged AFTA over APEC as a vehicle for regional trade liberalisation? Similarly, why has financial cooperation become a key item on the APT agenda rather than at the ASEAN or APEC levels? Finally, what accounts for the growing interest in bilateral arrangements?

The Argument in Brief

To answer these questions, the paper uses the institutional bargaining perspective to trace first, how different types of external shocks stimulated the initial turn to regional institution building. The analysis shows that the distinct nature of the goods being sought by the Southeast Asian states – namely securing foreign investment flows, export markets and access to short-term liquidity – reinforced by the international economic position of these countries, and the prevailing institutional context explains the choice of institutional arrangement.

While the waning Cold War contributed to the creation of APEC in 1989 as a way to keep the U.S. engaged economically (and strategically) in the region, growing perceptions of a foreign investment ‘crisis’ were responsible for the establishment of AFTA in 1992 and in particular, helps explain moves to expand its agenda and enhance its implementation from the mid-1990s. AFTA, and later the AEC, represent strategies by which member governments in Southeast Asia have sought to create within Southeast Asia a single, integrated market out of individually small markets in order to counter the perceived threat of foreign investment diversion from their countries to other large markets, especially China. The political commitment to ASEAN economic integration coincides with the search by foreign investors for regional

production spaces beyond small, national markets in which to build transnational production networks. In contrast, an economic preoccupation with maintaining export markets, especially the crucial U.S. market, accounts for Southeast Asian participation in APEC despite the misgivings many of these governments had about APEC. The need to secure access to markets and investment also accounts for the turn by a number of Southeast Asian countries to bilateral FTAs since the late 1990s as insurance policies, given the ongoing stalemate at the WTO. However, strategic considerations also explain the bilateral turn in many other cases, like Singapore's move to negotiate bilateral FTAs with small Middle-Eastern economies that are not its traditional trading partners. Both economic and strategic considerations also account for the bilateral FTAs that ASEAN has embarked on, especially with China.

A further external driver of new institutional arrangements in Southeast Asia was the devastating experience of the 1997-98 Asian financial crisis, which prompted strong interest in ASEAN to develop a greater regional capability in preventing and responding to future crises that ASEAN policymakers believed to be inevitable if global financial markets remained weakly regulated. However, developing an effective regional financing mechanism that would help in this process required the help of ASEAN's richer Northeast Asian neighbours, especially Japan and China with their considerably larger financial reserves. This explains why the CMI could not be undertaken at the ASEAN level, although it does not fully account for why it emerged as a project of APT rather than APEC.

Additional explanatory leverage in all three cases is provided by the cognitive frameworks held by policymaking elites in Southeast Asia as well as the nature of domestic distributional coalitions. Thus, the belief that global investment flows are determined in part by investors seeking large, integrated markets in which to locate regionalised production networks

accounts for the preoccupation of the ASEAN member countries with regional economic integration through AFTA and the AEC as the most viable approach to secure their share of globally mobile investment. New understandings both in ASEAN and worldwide that regional free trade areas can help integrate participating member countries with the world economy rather than insulate them from global markets, a shift from the thinking of the 1970s and 1980s, reinforced the turn to AFTA.

Despite these shared beliefs, domestic distributional politics undermined the implementation of AFTA commitments in a number of key sectors, notably automobiles, petrochemicals and agriculture. Countries like Malaysia and Indonesia backtracked on their liberalisation commitments to protect politically important domestic groups that operated in these sectors. Domestic concerns in some countries that ASEAN economic integration will undermine domestic businesses, including state-owned firms and private businesses closely allied to the political elite, continue to hamper the AEC. These domestic dynamics are prevalent across Southeast Asia and operate irrespective of political regime type. Similar domestic considerations as well as shared developmental ideologies amongst many Southeast Asian governments that emphasised state intervention in markets also prompted their cautious approach to APEC. Concerned that APEC would be dominated by western states imposing their preferred neoliberal approach to economic growth, the Southeast Asian governments sought to reduce any potential for their domination in APEC by insisting on unilateralism and non-binding agreements as APEC's guiding principles, notwithstanding their broad embrace of the free trade principles that lay at the heart of APEC.

In the case of regional financial cooperation, policymaking elites' strong belief in systemic vulnerability – that minimally regulated global financial markets have the potential to

generate financial crises like that of Asia's in 1997-98 – encouraged them to turn to the APT to develop a self-help capability in managing future crises. They were not keen on locating this project within APEC, of which the U.S. is a member. APEC's initial emphasis that domestic irregularities in crisis-affected countries were the sole cause of the financial crisis did not inspire confidence in APEC's Asian members that the grouping was the appropriate institutional site for developing a regional liquidity facility. The U.S., moreover, was not interested in supporting what could eventually turn out to be a regional alternative to the IMF. Advances on the CMI and the bond fund projects⁴ later adopted by the APT were also facilitated by the absence of domestic opposition. These projects promised economy-wide gains while their domestic distributional effects were far fewer and less clear-cut, unlike the case with trade liberalisation.

Before elaborating on these arguments in Section III, Section II provides a brief discussion of institutional arrangements governing Southeast Asia's economic relations during the Cold War period. The final two sections of the paper explore the implications of Southeast Asia's new institutional arrangements for Southeast Asia itself and beyond. The discussion focuses on whether these different arrangements conflict with or reinforce each other, how they might evolve over the next five to ten years, and what their implications might be for the global economic order.

⁴ The APT launched the Asian Bond Market Initiative in 2002 to help member states develop the necessary domestic infrastructure to support well-functioning bond markets. See Amyx (2004) p.16. This paper will focus its analysis on the CMI, as the dynamics behind both projects are broadly similar.

II. SOUTHEAST ASIA AND REGIONAL ECONOMIC COOPERATION IN THE 1970s AND 1980s

Economic cooperation in Southeast Asia was formally initiated in 1977 under the auspices of ASEAN. Although the 1967 Bangkok Declaration establishing ASEAN highlighted economic cooperation as a key goal,⁵ no concrete projects in this area were developed despite the availability of a United Nations report on ASEAN economic cooperation that had been commissioned by the ASEAN foreign ministers in 1969.⁶ Instead, ASEAN focused on building confidence between member states through regular consultations among its members on a host of shared intra-regional and wider political and security issues.⁷ The emphasis on regional rapprochement was not surprising given that ASEAN's formation in 1967 had been aimed at overcoming the tensions and rivalries that characterised relations between these countries during the 1960s.⁸ Peace and security between former rivals was regarded as vital to enable member governments to devote their attention to national economic growth, which these governments believed to be the primary route to social and political stability in divided [post-colonial] societies and through that, to secure their own political legitimacy.⁹

The primary impetus for economic cooperation in 1977 was external. The fall of South Vietnam in 1975 prompted concerns with enhancing ASEAN's security and cohesion. It led the ASEAN members to adopt the Treaty of Amity and Cooperation in Southeast Asia (TAC) in 1976, nine years after ASEAN's founding, as the first formal agreement of the Association and

⁵ See ASEAN (1967).

⁶ Ravenhill (1995) p. 851.

⁷ Antolik (1986) pp. 17-19.

⁸ Acharya (1997).

⁹ Leifer (1989) pp. 3-4.

the first to be signed by heads of state.¹⁰ This document explicitly set out the regulative or behavioural norms of ASEAN in Article 2, namely respect for sovereignty, territorial integrity, non-interference in the internal affairs of another state, the pacific settlement of disputes, and renunciation of the threat or use of force.¹¹ The ASEAN members hoped that Vietnam would endorse ASEAN's principles of inter-state behaviour by signing on to the TAC even if it did not accept full ASEAN membership. It was a way to secure the ASEAN countries in the light of a shift in the balance of power in Southeast Asia.

In addition to the TAC, ASEAN also initiated four projects in regional economic cooperation as means to ensure ASEAN's own internal cohesion through closer economic collaboration. The Preferential Trade Arrangement (PTA) and the ASEAN Industrial Projects were both launched in 1977, the ASEAN Industrial Complementation (AIC) project was launched in 1981 and the ASEAN Industrial Joint Ventures (AIJV) project was initiated in 1983. Unfortunately, these four projects have faced considerable problems since their adoption.

Weak Economic Incentives Hamper Regional Economic Cooperation

Disagreements among member governments prevented some projects from even getting off the ground, while in others like the PTA, member governments' ability to exclude an extensive number of sensitive items from the preferential trading arrangement as well as governments' offer of tariff preferences on irrelevant items made a mockery of the PTA, the most notorious examples being the Philippines' offer of tariff preferences on snow ploughs and Indonesia's offer

¹⁰ The foreign ministers of ASEAN had signed the ASEAN Declaration (or Bangkok Declaration) that launched ASEAN in August 1967.

¹¹ ASEAN (1976).

of preferences on nuclear power plants.¹² By 1990, trade in the 16,000 items enjoying preferences under the PTA programme amounted to less than 1 percent of intra-ASEAN trade.¹³ The other three industrial cooperation projects suffered similar fates as members squabbled over the allocation of different industrial projects. Inadequate planning, weak financial and technical support, and little interest from the region's private sector were other factors that undermined these projects.¹⁴

The main problem was the absence of any *economic* need for a regional market during the 1970s and 1980s since all the ASEAN countries were trading far more with the industrial world than with each other. (see Table 1). Even without formal economic cooperation, the ASEAN countries registered credible economic performances during the 1970s and 1980s.¹⁵ (see Table 2). As such, the regional cooperation initiatives adopted by the ASEAN governments did not offer sufficient economic gains or fulfil any pressing economic need that would have generated the commitment needed by governments to overcome their different national interests and ensure that these projects were properly designed and successfully implemented. Although the economic projects initiated by ASEAN theoretically offered the small ASEAN countries a larger regional market to support the domestic industries that were being encouraged through import-substitution industrialisation, each government also wished to preserve its own domestic market for domestic firms, especially politically important ones, thereby making it difficult to

¹² See Ravenhill (1995) pp. 851-853 and ASEAN Secretariat (1997) p. 45.

¹³ Tan et al (1992).

¹⁴ See Ravenhill (1995) pp. 852-53, Bowles and MacLean (1996) pp. 321-22 and ASEAN Secretariat (1997) pp. 54-62.

¹⁵ The exception was the Philippines, which was mired in internal political turmoil during the Marcos era.

move regional economic cooperation beyond identification of new projects or the early stages of their implementation.¹⁶

Table 1: ASEAN: Direction of Trade, 1993 (%)

Country	USA	Japan	European Community	ASEAN, 1993	ASEAN, 1970
Exports					
Brunei	1.2	54.2	17.8	19.2	83.2
Indonesia	14.2	30.3	14.4	13.4	21.1
Malaysia	20.3	13.0	14.5	28.2	25.4
Philippines	38.3	16.3	16.8	7.1	1.2
Singapore	20.3	7.5	14.0	23.9	29.4
Thailand	21.6	17.0	17.0	16.3	14.9
ASEAN	19.9	15.7	15.0	20.2	21.4
Imports					
Brunei	20.2	5.4	27.1	38.3	49.4
Indonesia	11.5	22.0	19.9	9.3	7.6
Malaysia	16.9	27.5	11.6	20.0	22.5
Philippines	19.8	22.8	10.3	10.9	5.2
Singapore	16.3	21.8	11.5	21.8	26.7
Thailand	11.7	30.3	14.9	12.1	3.2
ASEAN	14.9	24.4	13.3	17.5	16.3

Source: ASEAN Secretariat (1997: 42)

Table 2: Growth Performance of ASEAN Countries, 1965-90 (%)

	Brunei	Indonesia	Malaysia	Philippines	Singapore	Thailand
Real GDP growth, 1980-91	na	5.6	5.5	0.8	6.4	7.6
Per capita GNP growth, 1965-90	na	4.5	4.0	1.3	6.5	4.4

Source: World Bank (1992)

Moreover, the cognitive framework shared by government officials and leaders during the 1970s and 1980s was of regional cooperation schemes constituting *alternatives* to

¹⁶ Bowles and MacLean (1996) p. 332.

participation in world markets and to reduce dependence on trade with industrial countries.¹⁷ Virtually all the ASEAN member countries rejected regional free trade schemes on these grounds lest they jeopardise their engagement with world markets. As the next section reveals, it was only when it became clear that regional free trade schemes could enhance countries' integration with world markets that an ASEAN-wide free trade area became possible.¹⁸ Interestingly, the ASEAN Swap Arrangement (ASA) launched by ASEAN in 1977 as a facility to provide U.S. dollars to member countries in the event of temporary balance of payments problems was relatively more successful in terms of its utilisation compared to the four projects described above. The US\$200 million facility was activated on five occasions, once each by Indonesia (1979), Malaysia (1980), and Thailand (1980) and twice by the Philippines (1981, 1992) although the amounts available through this mechanism were relatively small.¹⁹

The experience with ASA suggests how regional cooperation projects that provide clear economic gains with minimal inter-state and intra-state distributional effects have a far better chance of getting off the ground than projects that offer elusive economic gains but involve considerable distributional effects. This is clearly seen in the ASEAN experience with AFTA. The overall benefits theoretically promised by the regional free trade project prompted governments to overcome some, though not all of the domestic vested interests lobbied against AFTA. Before discussing AFTA, the paper first turns to a brief discussion of APEC, the first inter-governmental regional economic organization established across the Pacific.

¹⁷ Bowles and MacLean (1996) pp. 332-333.

¹⁸ Nesadurai (2003) pp. 78-82.

¹⁹ Henning (2002) p. 14.

III. NEW REGIONAL COOPERATION SCHEMES IN THE 1990s: APEC, AFTA AND APT

The establishment of APEC in 1989 was significant as it was the first inter-governmental regional organization of its kind in the Asia Pacific region to group both developed and developing countries from both sides of the Pacific Ocean.²⁰ The idea for a trans-Pacific regional organization had been first proposed in the 1960s when Japanese economist Kiyoshi Kojima suggested forming a Pacific Free Trade Area (PAFTA), later re-crafting his original proposal to a more modest Organization for Pacific Trade and Development (OPTAD). Although not formally adopted, the idea of trans-Pacific regionalism was kept alive during the 1970s and 1980s by a group of economists and business persons who began meeting regularly in a variety of non-governmental bodies that aimed to promote Pacific-wide consultation on economic policy matters. These were the Pacific Trade and Development Forum (PAFTAD) and the Pacific Basic Economic Council (PBEC) both established in the mid-1960s as well as the Pacific Economic Cooperation Conference (PECC) launched in 1980 (later it became the Pacific Economic Cooperation Council).²¹

Although these non-governmental or Track II bodies played a key role in maintaining the idea that a regional inter-governmental institution was clearly needed to manage the growing economic interdependence in the Asia-Pacific, this is not sufficient to explain why the APEC

²⁰ APEC's founding membership included the (then) six ASEAN members (Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand), two Northeast Asian countries (Japan, South Korea) and Canada, the US, Australia and New Zealand. In 1991, the 'three Chinas' (China, Hong Kong and Taiwan) were admitted, while Mexico and Papua New Guinea joined in 1993, and Chile in 1994. In 1998, APEC's membership expanded to 21 with the inclusion of Peru, Russia and Vietnam. There is currently a moratorium on further expansion.

²¹ Morrison (2006) pp. 206-210.

project was only adopted in 1989 two decades after the idea of trans-Pacific regionalism was first expressed.²² Moreover, the Southeast Asian governments had deep reservations about the formation of APEC, seeing it as an attempt to undermine ASEAN. These governments were also concerned that such an organisation might be steered by its western members led by the U.S. and Australia to adopt a regional trade liberalisation agenda as a way to prise open markets in East Asia.

APEC and the end of the Cold War

A major external driver for the successful establishment of APEC in November 1989 was the expected end of the Cold War, which raised a new set of strategic concerns for the Southeast Asian states that paved the way for trans-Pacific regionalism. By the late 1980s, there was rising concern among governments in Southeast Asia that the U.S. would withdraw militarily from the Pacific region. Growing sentiments in the U.S. Congress that East Asian countries were discriminating against American goods, services and investment while not shouldering their share of the military burden of maintaining security in the Pacific region compounded these fears, made worse by rising U.S. trade imbalances with countries in the region. The waning Cold War made it less likely that Washington would continue to tolerate discriminatory economic practices in Japan, South Korea and Taiwan as it had since the 1950s when these countries became key allies in American Cold War strategy in the Pacific. The unfolding developments of the 1980s made U.S. economic and military retrenchment from the region a very real possibility.²³

²² Ravenhill (2002) pp. 62-65.

²³ Ravenhill (2002) p. 62.

In these circumstances, APEC offered the Southeast Asian countries (and the Northeast Asian countries as well) a means to sustain U.S. strategic interests in the region and to potentially manage trans-Pacific trade disputes by moderating Washington's growing resort to unilateral market opening actions. Given the slow progress on the Uruguay Round of trade negotiations during this period as well as the move to establish regional markets in western Europe and North America, it was not surprising that the Southeast Asian governments, increasingly reliant on open world markets to support their export-dependent growth, became worried by the spectre of fragmentation and possibly even closure of the world economy. The U.S. was a major export market for East Asia, absorbing about a fifth of ASEAN's total exports in 1989 and a third of Japanese and South Korean exports.²⁴ Despite their initial reservations, the ASEAN governments came on board the project in 1989 as they recognised that APEC offered them the best chance of keeping the U.S. engaged economically and strategically in the region. Southeast Asia's concern that APEC would overshadow ASEAN was also overcome to some extent by extensive consultations between ASEAN and Australia, one of APEC's main proponents, who gave assurances that ASEAN would be granted a central role in the new organization.²⁵

What Accounts for APEC's Institutional Design? Nevertheless, this account of the formation of APEC still leaves one puzzle unanswered. If the ASEAN governments wished to ensure continued U.S. economic and strategic engagement with the region, then these governments should, at least, have attempted to accommodate to Washington's economic interests in the Pacific. Growing regional economic interdependence also suggests that the Southeast Asian

²⁴ Ravenhill (2002)p. 77.

²⁵ Ravenhill (2002)p. 84.

countries would have attempted to ensure that APEC would be effective in reducing the problems generated by economic interdependence, including liberalising existing barriers to regional trade.²⁶ The domestic liberalisation drive in Southeast Asia from the mid-1980s should have made such an exercise possible. Yet, APEC was designed in a way that undermined its potential to promote more effective regional collaboration and regional liberalisation, eventually leading to U.S. disinterest in the institution. To account for this, we need to turn to domestic factors and shifts in the broader institutional context.

Although most of APEC's Southeast Asian members had relatively open economies, especially with the new round of liberalisation undertaken since the mid-1980s recession, these governments were, nevertheless, concerned that any hasty liberalisation would undermine their own industrialisation efforts as well as their ability to use economic policies to realise domestic socio-political priorities. Ever mindful that Washington could use APEC to force through liberalisation of their economies in ways or at a pace unacceptable to them, APEC's Southeast Asian (and Northeast Asian) members insisted on unilateralism and consensus as APEC's guiding principles and secured a commitment that APEC would function solely as a dialogue process rather than a negotiating forum for regional liberalisation. This particular *modus operandi*, self-styled 'open regionalism',²⁷ has helped Southeast Asian governments retain considerable policy autonomy within the grouping, especially when APEC adopted a regional liberalisation agenda following its first leaders' summit in 1993. APEC's new programmes in trade and investment liberalisation as well as competition policy are based on non-binding,

²⁶ Interdependence among APEC economies, measured in terms of intra-APEC trade as a share of total trade, grew from 56.9 percent in 1980 to 66.4 percent in 1985 and 68.5 percent by 1989. See Ravenhill (2002) p. 73.

²⁷ Open regionalism has been defined as an approach to regional liberalisation based on unilateral offers by members that could be extended to non-members on an MFN basis. See Drysdale and Garnaut (1993) pp. 187-188.

unilateral/non-negotiated commitments issued through Individual Action Plans that will be flexibly implemented.²⁸ This approach, later termed ‘concerted unilateralism’, effectively allows each member government considerable discretion in determining the substantive concessions it is willing to make and its schedule of liberalisation.²⁹

The insistence on concerted unilateralism meant, however, that the U.S. lost interest in APEC, especially after the 1998 Kuala Lumpur Summit when negotiations between Japan and the U.S. collapsed when the former insisted that its liberalisation commitments in the forestry, fisheries and agriculture sector were non-binding.³⁰ With its liberalisation agenda in tatters, APEC now focuses on trade facilitation and economic/technical cooperation, issues that Washington does not care too much about. It was probably because such a vacuum existed in APEC in the first place that the global security concerns of the U.S. centred on terrorism could quite easily assume centre-stage at the 2003 APEC Leaders Summit in Bangkok when a range of anti-terrorism measures were adopted,³¹ much to the disquiet of a number of APEC members and the business community.³² For many of its members, APEC has clearly ‘taken a back seat’ as an exercise in regional economic liberalisation.³³

Although APEC’s Asian members had initially seen the project as a way to maintain continued access to markets, especially in the U.S., changing international conditions since APEC’s early years reduced the external pressure on the Southeast Asian members that might

²⁸ Urata (1998).

²⁹ Plummer (1998) p. 308.

³⁰ Ravenhill (2002) p. 235.

³¹ APEC (2003) provides a list of the anti-terrorism measures adopted.

³² *The Straits Times*, ‘APEC out of touch, say businessmen’, 22 October 2003.

³³ Ravenhill (2002) p. 241.

have led them to be more forthcoming with regard to APEC's liberalisation agenda. Not only were the U.S. and other global markets still open to Asia-Pacific exports in the 1990s, the Uruguay Round negotiations were successfully completed by 1994 and the WTO formed. In other words, the original external pressures for securing export markets that had prompted Southeast Asian participation in APEC had become rather marginal by the mid-1990s. Moreover, the Southeast Asian countries also had their own regional project, AFTA, through which they attempted to collectively respond to structural shifts in the global economy that governments believed could pose problems for their economies.

AFTA and the FDI Imperative

When the six ASEAN leaders announced in 1991 that they had decided to form AFTA,³⁴ scholars and the business community remained unconvinced that the project would take off, even in its initial limited form.³⁵ The project was originally designed to lower tariffs on manufactured goods and processed agricultural products to between 0-5 percent by 2008 over a fifteen year period beginning in January 1992. To its critics, the economic incentives necessary to sustain a free trade area in ASEAN were far from overwhelming since member countries were not natural trading partners and were, instead, far more closely linked through trade and investment flows with countries outside the ASEAN grouping. In 1990, intra-ASEAN exports among the six members constituted about 20 percent of their total trade while their exports to the industrial countries totalled 58 percent of total exports.³⁶

³⁴ The six founding members of AFTA are Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand. The new members of ASEAN (Vietnam, Laos, Myanmar and Cambodia) acceded to AFTA upon joining ASEAN.

³⁵ *New Straits Times*, 'Delegate: Thai proposal not viable', 25 July 1991.

³⁶ Calculated from the IMF (1996).

Yet, the AFTA project was sustained, its pace accelerated and its scope expanded from what was initially planned. Its six founding members agreed to bring forward the date of AFTA's completion to 2002 when tariffs on all manufactured products and processed agricultural products were targeted at 0-5 percent while a zero tariff ASEAN for the six original signatories is due in 2010. The scope of regional free trade was expanded to include liberalisation of unprocessed agricultural products, services and investment, all potentially contentious issue areas that member governments had initially excluded from regional liberalisation, giving rise to a fairly comprehensive project of ASEAN economic cooperation. Although implementation of these ambitious commitments has been problematic,³⁷ their adoption is in itself significant, irrespective of the implementation record, as it indicates the willingness of these governments to submit these areas to joint decision-making, something they were averse to in APEC. Disjuncture between commitments and implementation is not uncommon in international cooperation, and is usually attributed to domestic political developments or changes in the external environment facing countries.³⁸

AFTA, Regional Market Creation and the FDI Imperative. Officials preparing for the 1992 Singapore Summit at which the decision to establish AFTA was formally adopted admit that one of the most compelling arguments advanced for the project, and which convinced ASEAN leaders of its necessity, was its capacity to attract FDI to the region.³⁹ The early 1990s saw each of the five original ASEAN members face falling applications for foreign investment approvals.⁴⁰ ASEAN's share of global FDI

³⁷ Detailed in Nesadurai (2003) pp. 128-150.

³⁸ Chayes and Chayes (1993) pp. 195-201.

³⁹ Akrasanee and Stifel (1992).

⁴⁰ For details, see Nesadurai (2003) pp. 82-87.

flows declined from a high of 35 percent in 1990 to 24.3 percent by 1992.⁴¹ By the end of 1992, ASEAN leaders had become anxious that any large-scale diversion of FDI from the region could disrupt economic growth.⁴² (See Table 3). FDI had become a crucial source of growth in Southeast Asia since the mid-1980s, and consequently, critical to social and political stability. Growth, in turn, was the primary basis of political legitimacy in this part of the world.⁴³

Table 3: Flows of FDI to host region/economy, 1983-1998 (US\$ million)

	Total FDI Flows	Industrial countries	All developing countries	ASEAN countries^a	(%)	China	(%)
1983-88	91,554	71,779	19,757	3,708	5.2	1,823	2.5
1988	159,101	131,313	27,772	6,991	25.2	3,194	11.5
1989	200,612	171,722	28,622	7,591	26.5	3,393	11.9
1990	211,425	176,436	34,689	12,158	35.0	3,487	10.1
1991	158,936	114,792	41,696	13,400	32.1	4,366	10.5
1992	173,761	119,692	49,625	12,074	24.3	11,156	22.5
1993	219,421	133,850	78,813	15,994	20.3	27,515	34.9
1994	253,506	146,379	101,196	19,681	19.4	33,787	33.4
1995	328,862	208,372	106,224	21,643	20.4	35,849	33.7
1996	358,869	211,120	135,343	25,980	19.2	40,180	29.7
1997	464,341	273,276	172,533	27,813	16.1	44,236	25.6
1998	643,879	460,431	165,936	21,400	12.9	45,460	27.4

^a Includes all ten ASEAN member economies

Note: Percentage figures refer to investment flows as a proportion of total flows to developing countries

Sources: UNCTAD, World Investment Report, 1999; ASEAN Secretariat (1999a:131-32)

⁴¹ Nesadurai (2003) p. 81, Table 3.1.

⁴² ASEAN Secretariat (1999) p. 129. Between 1987 and 1992, inward FDI flows accounted for a large 11.3 percent of gross fixed capital formation in ASEAN, compared to 3.9 percent for developing countries and 4.2 percent for industrial countries. By 1990, total FDI stock in ASEAN accounted for 18.2 percent of GDP compared to between 10.3 – 10.5 percent for Asian and all developing countries and 8.4 percent for the industrial countries. For Malaysia, Indonesia and Singapore, the role of FDI in the national economy was even higher than the ASEAN average. Total FDI stock in these three countries represented respectively 24 percent, 37 percent, and 74 percent of GDP by 1990, up from 21 percent, 14 percent and 53 percent a decade earlier.

⁴³ Nesadurai (2003) pp. 82-87.

The fact that a *regional* response to these emerging pressures was considered rather than individual national responses to make economies more attractive to foreign investors can be explained by the way ASEAN officials and leaders construed the FDI ‘crisis’ facing them. ASEAN senior officials were, at this time, engaged in extensive consultations with regional scholars and business actors with regard to charting new directions for the Association following the expected resolution of the Cambodian conflict, which had taken up much of ASEAN’s attention during the 1980s. These consultations took note of the growing number of reports that identified diversion of FDI from ASEAN as the main implication of regional free trade schemes in North America (NAFTA) and Western Europe (the Single European Market).⁴⁴ These studies helped persuade ASEAN officials that a similar regional project in ASEAN would be the appropriate policy response. The views of the ASEAN leaders can be summed up in the words of Thailand’s Prime Minister in 1993, Chuan Leekpai, who cautioned, ‘the possible diversion of direct foreign investment to emerging groupings such as the Single European Market and NAFTA is a perpetual reminder that smaller countries have to unite’.⁴⁵ As a result of its renewed economic reform effort in 1992, China too came to be seen in these terms, as a direct competitor with ASEAN for foreign investors seeking suitable investment/production sites in the Asia-Pacific region.

These perceptions about FDI diversion were reinforced by growing investor interest in the regional markets that were being constructed in North America and Western Europe as well as investors’ attraction to continental-sized markets like China. By the late 1980s, multinational

⁴⁴ Means (1995).

⁴⁵ *Business Times*, ‘Stepped-up liberalisation of trade can be expected: Chuan’, 8 January 1993.

corporations (MNCs) were increasingly practising a regional as opposed to a global division of labour by establishing similar production networks in three different regions of the world economy – Europe, North America, and the Asia-Pacific.⁴⁶ While the aim of MNCs was to operate business globally, that goal was being increasingly achieved through the development of ‘complete and integrated production and management systems within definable regions’.⁴⁷ ASEAN leaders and policymakers were convinced that AFTA offered them a way to meet the FDI challenge, especially from China, by providing global investors with what they were looking for, namely a regional production space in the Asia-Pacific that was an alternative or supplement to China. This regional market-creating strategy was all the more compelling, as national officials believed they had reached a limit in terms of the individual investment incentives they could realistically offer to attract investors.⁴⁸

Despite their concern with using AFTA as an instrument through which to attract FDI to the region, the ASEAN governments did not put in place rules and institutions that would bind members to implement their commitments under AFTA. In line with long-held practice during the preceding 25 years of ASEAN, member governments opted for limited institutional mechanisms to support regional liberalisation.⁴⁹ It was only later, from the mid-1990s when implementation of the first set of AFTA commitments was due and member governments began backtracking on offers already made, that members adopted new rules and binding protocols to govern regional liberalisation. Setbacks in implementation set in motion a process of negotiations between member countries over the terms of conditions of liberalisation, which led

⁴⁶ Ng and Sudo (1991) and Oman (1994).

⁴⁷ Rodan (1993) p. 234.

⁴⁸ Nesadurai (2003) p. 88.

⁴⁹ On the path dependence of institutional development in ASEAN, see Khong and Nesadurai (2005).

to both the downward revision of original targets as well as a process of rule building. The former measure allowed the domestic concerns of countries like Indonesia to be taken into consideration during implementation, thereby helping to keep these members on board the project. The latter helped institutionalise the liberalisation process through adoption of a set of clearer rules and procedures for regional trade liberalisation, including annual liberalisation schedules and rules governing the treatment of temporary exclusions including their eventual termination.

Three new sets of procedural rules were also adopted involving fairly detailed, binding protocols that required domestic ratification: a dispute settlement mechanism in 1996,⁵⁰ a notification protocol in 1998 that obliged members to notify ASEAN before withdrawing concessions already offered,⁵¹ and in 2000 a protocol for governing how concessions already offered could be modified.⁵² The Protocol on Sensitive and Highly Sensitive Agricultural Products⁵³ adopted in 1999 similarly provides rules to govern agricultural trade liberalisation, including provisions for its flexible implementation and rules on exempting sensitive agricultural items. Both the agriculture and the notification protocol were negotiated following Indonesian backtracking on its initial liberalisation offers on four agricultural commodities (rice, sugar, cloves and wheat), and in raising duties on selected petrochemical products without informing its ASEAN partners. Malaysia's request to temporarily withdraw automobiles from AFTA disciplines in late 1999 prompted the negotiation of the protocol on modifying concessions,

⁵⁰ ASEAN (1996).

⁵¹ ASEAN (1998).

⁵² ASEAN (2000).

⁵³ ASEAN (1999).

which incorporates financial compensation to states damaged by the alteration of original concessions, albeit to be negotiated among the parties affected.

These compromises, far from being detrimental to the AFTA project, were, however, important to its continuation despite being a 'second-best' outcome. Because it was difficult for any one member to dominate these processes and secure unconditional benefits, a process of 'give-and-take' emerged. Otherwise, officials concede that the AFTA project had been in danger of collapsing.⁵⁴ Instead, the end of 2002 saw the successful conclusion of the first phase of AFTA, with tariffs on 99 percent of all products traded within the region set below the targeted 5 percent and involving US\$1.4 billion of tariffs.⁵⁵ Sensitive agricultural products follow a clearly defined though delayed schedule, while Malaysian automobiles were exempted until 2005 when these items became subject to AFTA tariff reduction schedules once again. Moreover, the extended deadlines permitted for new members have helped keep Vietnam, Laos, Myanmar and Cambodia on board the project.

Although AFTA had limited impact on intra-ASEAN trade, which rose to about 25 percent in 2002 from the pre-AFTA average level of 20 percent,⁵⁶ surveys of Southeast Asian and foreign corporate leaders, on the other hand, reveal that by the mid-1990s, AFTA had already begun impacting corporate decision-making, business operations and on firms' regional production strategies.⁵⁷ Business interest in the regional market is reflected in the growth of

⁵⁴ Reported in Nesadurai (2003) pp. 154-58.

⁵⁵ From ASEAN Secretariat (2004) p. 17. Also see the statement by ASEAN Secretary General, Ong Keng Yong, reported in *IHT*, 'Pacific nations rush to sign free trade pacts', 12 March 2005.

⁵⁶ Intra-ASEAN trade has, however, grown slightly faster than ASEAN's trade with the rest of the world.

⁵⁷ The survey results are reported in Baldwin (1997) p. 126, ASEAN Secretariat (1999) p. 16 and *The Sunday Times*, 'Are Japanese businesses leaving for China?', 15 September 2002.

regional production networks across Southeast Asia involving two or more member countries, especially in electronic and electrical products, telecommunications equipment, automobiles and food manufacturing.⁵⁸ This regional division of labour is reflected in the growing proportion of intra-industry trade within the region. Trade in intermediate inputs now accounts for a growing proportion of total intra-ASEAN trade, especially in the all-important electrical, electronics and telecommunications equipment sectors, accounting for 45 percent of total intra-ASEAN trade.⁵⁹ Recent analyses reveal a high degree of regional integration in these sectors with AFTA cited as one factor accounting for this trend.⁶⁰ Yet, there is a low degree of utilisation of AFTA tariff preferences by regional businesses due to high administrative costs while market fragmentation persists due to differences in domestic business regulations, divergent product standards and weaknesses in customs clearance.⁶¹ Thus, the quest by ASEAN to offer investors a ‘seamless,’ integrated regional market as an alternative regional production site to China remains only partially realised, and accounts for the adoption of the ASEAN Economic Community (AEC) project in 2003. Unsurprisingly, business groups such as the U.S.-ASEAN Business Council and the ASEAN Business Advisory Council have been lobbying ASEAN members to hasten the process of deep integration.⁶²

⁵⁸ ASEAN Secretariat (1999) p. 16. See also Felker (2004).

⁵⁹ Rajan (2004).

⁶⁰ Austria (2004) p. xxxiv.

⁶¹ Tongzon (2005).

⁶² US-ASEAN Business Council (2004). See also *Borneo Bulletin*, ‘Brunei: regional leaders laud ASEAN’s BAC efforts’, 13 October 2003.

The ASEAN Economic Community (AEC): Unfinished Business in Regional Market Creation.

The AEC is driven by the same FDI logic that drove regional market creation through AFTA, but aims to go beyond AFTA to consolidate regional liberalisation in services and investment that began in the mid-1990s, further reduce non-tariff barriers, harmonise product standards, as well as aim for the limited movement of skilled and professional workers within Southeast Asia.⁶³ Its ultimate goal is to achieve by 2020 a ‘seamless,’ integrated Southeast Asian market and production base that can act as a magnet for investments through its combined population of 500 million people and a combined GDP of US\$685 billion.⁶⁴ Under the AEC, a fast-track integration programme for eleven priority sectors has already been formulated and the dispute settlement process enhanced.⁶⁵

There is clearly strong recognition among the ASEAN states that regional economic integration is necessary if these states are to remain an attractive destination for investment.⁶⁶ Much will, however, depend on how national governments balance competing domestic interests and socio-economic priorities when making and implementing their liberalisation commitments, no easy task given that ASEAN comprises countries at vastly different levels of development. Governments are conscious of the potential domestic upheavals that are likely to result from an overly rapid pace of regional liberalisation. There are also national aspirations to develop local entrepreneurs and firms, which leads governments to be wary of opening up too fast lest

⁶³ ASEAN (2003).

⁶⁴ Hew (2005) p. 4.

⁶⁵ For details, see ASEAN, *Framework Agreement for the Integration of Priority Sectors*, Vientiane, Laos, 29 November 2004. (www.aseansec.org/16660.htm).

⁶⁶ Ramos (2005) and Tongzon (2005) p. 145.

fledgling domestic firms are wiped out by foreign firms and multinationals. Hence, ASEAN is now contemplating flexible modalities for the AEC.

Bilateralism and Other Arrangements

Singapore has, as a result, become impatient with the pace of ASEAN economic integration and has become a strong advocate of bilateral trade arrangements. However, Singapore's shift towards bilateralism was initially prompted by expectations of failure of the 1999 Seattle Ministerial Conference of the WTO.⁶⁷ Singapore is the most active proponent of the bilateral instrument, having concluded nine different FTAs (Australia, New Zealand, Japan, South Korea, the U.S., the European Free Trade Association, India, Jordan and a Trans-Pacific agreement with Brunei, New Zealand and Chile) while negotiations with 11 states are ongoing (Bahrain, Canada, Egypt, Mexico, Pakistan, Panama, Peru, Sri Lanka, Kuwait, Qatar and United Arab Emirates).⁶⁸ Singapore's signing of these trade deals, especially with major markets such as the U.S. and Japan has prompted other ASEAN countries initially critical about bilateral deals to bandwagon lest they are left out of key export markets, especially with the stalemate at the WTO.⁶⁹ Thailand has signed or is pursuing agreements with the U.S., New Zealand, Australia, China, and Japan while Malaysia has signalled its intent to pursue bilateral trade agreements with the U.S. and Australia while talks with Japan are ongoing.

⁶⁷ Desker (2004) p. 15.

⁶⁸ Ministry of Trade and Industry, Singapore. (<http://app.fta.gov.sg/asp/index.asp>, accessed November 29, 2005).

⁶⁹ Other political/strategic motivations are also behind the spurt in bilateral deals negotiated by Southeast Asian countries. See Dieter (2005).

Despite its embrace of bilateralism, even Singapore remains convinced that ASEAN economic integration is crucial for small economies.⁷⁰ In fact, the AEC project was initiated by Singapore amidst strong concerns about the competition that China posed to the ASEAN states, especially as a location for investment/production. It will be China's consolidation as an economic powerhouse, and in particular, the looming completion of the ASEAN-China FTA (ACFTA) first adopted in November 2001 that is likely to push ASEAN members to hasten market integration within Southeast Asia before trade with China is fully liberalised.

When China first proposed forming a FTA with ASEAN in November 2000, there were deep reservations on the part of many ASEAN members over the effects on their economies of liberalising trade with China, their main economic competitor.⁷¹ The project was clearly of great benefit to China, as it would enhance its strategic role in the region. Despite their reservations, ASEAN formally endorsed the ACFTA in November 2001. It would not only have been difficult for ASEAN to reject the Chinese proposal given ASEAN's own strategic interest in engaging China, the ASEAN leaders soon came to recognise the gains to their respective economies from closer economic cooperation with China. Studies undertaken in ASEAN to gauge the effects of an ACFTA identified investment opportunities for local firms in China, gains from preferential access of ASEAN products to the China market and to Chinese investment, as well as benefits of sourcing lower priced final products and intermediate inputs from China. However, a fully operational ACFTA is scheduled for 2010 at the earliest in order to help ASEAN consolidate

⁷⁰ Speech by Singapore Prime Minister, Lee Hsien Loong delivered in Tokyo at the 11th International Conference on The Future of Asia. Reported in *The Straits Times*, 'The way ahead in East Asian Cooperation', 26 May 2005.

⁷¹ See *Business Times (Singapore)*, 'All eyes on China push for FTA', 24 November 2000.

itself as a fully integrated regional site for production and for domestic industries to make the transition to competing first in ASEAN.⁷²

On its part, China has sought to allay the concerns of its partners by offering an ‘early harvest’ programme under the ACFTA, whereby it unilaterally offers ASEAN countries a quick reduction of tariffs on a number of goods without the need for immediate reciprocity. China has also agreed to extend MFN status to ASEAN’s least developed members, namely Vietnam, Laos, Cambodia and Myanmar while according them special and differential treatment in trade liberalisation, effectively opening up the China market to their exports far earlier than Chinese products will gain access to the markets of these countries. The sum total of these and other accommodating gestures from China towards ASEAN is that ASEAN has become much more assured that China intends to be a ‘long-term friend.’⁷³

Export growth from ASEAN to China rose sharply from 8 percent per annum during 1989-2000 to 15.2 percent during 2000-2004, while import growth also showed a similar sharp rise from 6.5 percent to 14.2 percent respectively.⁷⁴ Moreover, there is growing integration of the two ‘regions’ through intra-industry trade in certain heavily traded sectors. For instance, the share of parts and components in ASEAN’s exports of machinery and transport equipment to China is now at a high of around 62 percent while these items constitute 50 percent of imports in this category, having risen from between 20-25 percent in 1990.⁷⁵ While there remains a number of security-related issues that might undermine the ASEAN-China relationship, notably over territorial claims in the South China Sea, even here, China is displaying a remarkable

⁷² Nesadurai (2003) pp. 180-81.

⁷³ Ba (2003).

⁷⁴ Athukorala (2005).

⁷⁵ Athukorala (2005).

accommodation with ASEAN.⁷⁶ As with the Chinese case, ASEAN's pursuit of bilateral trade arrangements with India, Japan, South Korea and the Australia-New Zealand grouping has been prompted largely by the economic gains these links are expected to offer ASEAN (markets, investment, inputs) although strategic considerations are not unimportant.

The Asian Financial Crisis, APT and Regional Financial Cooperation

ASEAN Plus Three (APT) cooperation emerged gradually out of a series of ad-hoc discussions held between the ASEAN governments and Japan, China and South Korea beginning from 1996 to prepare the Asian agenda for the Asia-Europe Meeting (ASEM).⁷⁷ The first of the dedicated APT meetings (that is, not as a preparatory meeting for some other forum) occurred on the sidelines of the Second ASEAN Informal Summit held in 1997 in Kuala Lumpur. Since then, annual APT Summits have been held on the sidelines of the annual ASEAN Summits, while APT meetings of finance ministers, economics/trade ministers, labour ministers and other ministers or deputies from other ministries are also held regularly, as have meetings of senior officials from a range of government agencies. By 1999 when leaders issued the *Joint Statement on East Asia Cooperation* at the Third APT Summit in Manila, ASEAN had already recognised that its prosperity was tied closely to Northeast Asia, thus making APT an increasingly important component of the regional economic architecture.⁷⁸ Two major reports were commissioned to set the direction for APT cooperation – the Report of the East Asia Vision Group of 2001 and the Report of the East Asia Study Group of 2002. The wide range of areas identified for cooperation

⁷⁶ Caballero-Anthony (2002).

⁷⁷ Stubbs (2002) p. 443.

⁷⁸ See the summary document, *ASEAN Plus Three Cooperation*, from the ASEAN Secretariat. www.aseansec.org.16581.htm, accessed September 7, 2005.

suggests that APT aspires to a fairly comprehensive agenda.⁷⁹ However, it is in the financial realm that APT has displayed its most concrete cooperative outcomes to date.

In May 2000, the APT Finance Ministers Meeting initiated the Chiang Mai Initiative (CMI), a regional liquidity facility that is aimed at using participating members' foreign exchange reserves when currencies come under attack. The primary impetus for this project was the 1997-98 Asian financial crisis, which revealed to policymakers in both Southeast and Northeast Asia the importance of having some form of *regional* capability in providing timely and adequate financing to support currencies in crises. The financial crisis also revealed to regional policymakers how the lack of effective regional crisis response mechanisms had led to over-reliance on the IMF and external parties like the U.S.. Political motivations with dismantling the East Asian developmental state had then influenced the way these parties designed crisis assistance policies, which are now seen to have exacerbated rather than directly addressed the crisis.⁸⁰ The hesitant approach adopted by the international community to Asian demands to reform the international financial architecture also meant that the systemic vulnerabilities associated with minimally regulated global financial markets would persist. This encouraged the East Asian governments to consider regional solutions rather than rely on global ones that did not appear to be forthcoming. These governments were also aware that another crisis cum contagion would need resources beyond the IMF's limited pool.⁸¹

⁷⁹ These are detailed in the *Final Report of the East Asia Study Group*, adopted at the November 2002 Summit of the ASEAN+3. www.aseansec.org/viewpdf.asp?file=/pdf/easg.pdf, accessed August 18, 2005.

⁸⁰ See Hall (2003).

⁸¹ Grenville (2001).

Why ASEAN Plus Three as the Site for Regional Financial Cooperation? The East Asian governments were, consequently, very determined to develop a self-help capability in the management of future currency and financial crises.⁸² These governments also explicitly acknowledged the APT as the most effective site from which to launch such initiatives. While the Southeast Asian countries also saw ASEAN as a possible site for regional financial cooperation, they recognised that the resources needed to provide them with a credible capacity to effectively respond to future currency attacks required resources beyond those available in Southeast Asia alone.⁸³ Neither was the Manila Framework Group (MFG) viewed as a viable site from which to launch regional financial cooperation.

The MFG was created in November 1997 by a group of APEC finance ministers as a more acceptable substitute for Japan's proposed Asian Monetary Fund (AMF) that had been rejected by the U.S. and the IMF.⁸⁴ The MFG has been widely criticised for its ineffectiveness,⁸⁵ and was dissolved in November 2004.⁸⁶ The inability or unwillingness of APEC to provide solutions or assistance to the crisis-affected countries also undermined the grouping's credibility in East Asian eyes. The role played by the U.S. in the way the IMF responded to the crisis further

⁸² PECC (2002).

⁸³ Speech by the Malaysian foreign minister, Syed Hamid Albar at the opening of the 33rd ASEAN Ministerial Meeting, July 2000. www.aseansec.org/4086.htm, accessed August 13, 2005.

⁸⁴ Although initiated under the APEC process, the MFG comprised only 14 APEC members, namely the six 'older' members of ASEAN, four Northeast Asian economies (China, Japan, Hong Kong, South Korea), Australia, New Zealand, Canada and the US.

⁸⁵ Wang (2002).

⁸⁶ Kawai and Motonishi (2005) p. 256, fn 7.

compromised APEC in which the U.S. is a major player.⁸⁷ Statements released by APEC leaders during the financial crisis also blamed the crisis solely in terms of domestic policy mistakes and dysfunctional domestic practices and institutional arrangements – crony capitalism – in the crisis-affected East Asian economies,⁸⁸ thereby contributing to the discomfort that East Asian governments had with APEC and the MFG. Moreover, the U.S., a major actor in APEC and the MFG, had indicated that it was not keen to participate in the development of any permanent regional financing arrangement although it did not attempt to block the CMI as it had the AMF.⁸⁹ It is not surprising that the APT finance ministers’ network rather than APEC or the MFG emerged as the key site for the CMI.

The CMI encompasses two components. The ASEAN Swap Arrangement (ASA) now provides the CMI with a funding pool of US\$2 billion. The bulk of funds for the CMI comes from its second component, namely the network of bilateral swap arrangements (BSA) negotiated between different pairs of APT countries. Bilateral arrangements were needed due to the difficulties associated with negotiating a multilateral arrangement with a set of diverse countries holding vastly different amounts of foreign exchange reserves. Nevertheless, by December 2004, funds available from the sixteen bilateral swaps negotiated totalled US\$36.5 billion, with individual countries able to draw on between US\$1-3 billion for up to 90 days,

⁸⁷ Author’s interview in Manila with a senior official from the Asian Development Bank (ADB), September 2005

⁸⁸ See for instance the Joint Ministerial Statement of the Fifth APEC Finance Ministers Meeting, Kananakis, Alberta, Canada, May 23-24, 1998.

(www.apecsec.org.sg/apec/ministerial_statements/sectoral_ministerial/finance/1998_finance.html) (accessed August 24, 2005).

⁸⁹ Amyx (2004, 2005)

renewable for two years.⁹⁰ By September 2005, the total CMI funding pool had increased to US\$54.5 billion, following a series of measures announced in May 2005 to improve the facility's effectiveness.⁹¹ (see Table 4).

Table 4: The Chiang Mai Initiative (as of September 2005)

BSAs	Swap Size (US\$ billion)	Total Funds Available	Conclusion Date
Japan-Korea	2.0 (1-way swap) ^a	US\$ 2.0 billion	July 4, 2001 (expired) Extended July 4, 2004
Japan-Thailand	3.0 (2-way swap)	US\$ 6.0 billion	July 30, 2001
Japan-Philippines	3.0 (1-way swap)	US\$ 3.0 billion	August 27, 2001 (expired) Extended August 27, 2004
Japan-Malaysia	1.0 (1-way swap) ^b	US\$ 1.0 billion	October 5, 2001
China-Thailand	2.0 (1-way swap)	US\$ 2.0 billion	December 6, 2001
Japan-China	3.0 (2-way swap)	US\$ 6.0 billion	March 28, 2002
Korea-Thailand	1.0 (2-way swap)	US\$ 2.0 billion	June 11, 2002
China-Korea	4.0 (2-way swap)	US\$ 8.0 billion	June 24, 2002 Expanded May 27, 2005
Korea-Malaysia	1.0 (2-way swap)	US\$ 2.0 billion	July 26, 2002
Korea-Philippines	1.0 (2-way swap)	US\$ 2.0 billion	August 9, 2002
China-Malaysia	1.5 (1-way swap)	US\$ 1.5 billion	October 9, 2002
Japan-Indonesia	6.0 (1-way swap)	US\$ 6.0 billion	February 17, 2003 Doubled August 31, 2005
China-Philippines	1.0 (1-way swap)	US\$ 1.0 billion	August 29, 2003
Japan-Singapore	1.0 (1-way swap)	US\$ 1.0 billion	November 10, 2003
Korea-Indonesia	1.0 (2-way swap)	US\$ 2.0 billion	December 24, 2003
China-Indonesia	1.0 (1-way swap)	US\$ 1.0 billion	December 30, 2003
Japan-Korea	3.0 (2-way swap)	US\$ 6.0 billion	May 27, 2005
TOTAL BSA		US\$ 52.5 billion	As of September 2005
ASEAN Swap Arrangement (ASA)	Among ASEAN-10	US\$ 2.0 billion	April 2005 (original sum: US\$1 billion)
TOTAL FUNDS		US\$ 54.5 billion	As of September 2005

Notes:

BSAs are bilateral swap arrangements concluded between the ASEAN+3 countries

^aThis amount excludes US\$5.0 billion committed by Japan under the New Miyazawa Initiative

^bThis amount excludes US\$2.5 billion committed by Japan under the New Miyazawa Initiative

Source: Nesadurai (2005)

⁹⁰ See the 'Joint Ministerial Statement of the ASEAN+3 Finance Ministers Meeting', Jeju, Korea, May 15, 2004.

www.aseansec.org/16116.htm

⁹¹ For details of these measures, see Nesadurai (2005).

International Reserve Position and the Role of Japan and China. Japan's role has been critical to the CMI. Having the largest pool of foreign currency reserves, Tokyo was able to get the CMI project quickly off the ground by concluding the first four bilateral swaps with Korea, Malaysia, the Philippines and Thailand within a year while a swap arrangement with China was concluded in March 2002. The Japanese finance ministry had been responsible for initiating the proposal for a network of swap arrangements that later became the CMI and then designing and negotiating the general terms for these arrangements.⁹² Although it was not a major proponent of the project, China too has used its large pool of foreign reserves to conclude a total of five bilateral swap arrangements by the end of 2003 compared to Japan's seven. Only Japan and China had initially been in a position to take on the role of lender in these bilateral swap arrangements given their vast foreign currency reserves, respectively totalling US\$355 billion and US\$168 billion in 2000. In contrast, South Korea registered a reserve pool of US\$96 billion in 2000, while the largest reserve pool in ASEAN was US\$80 billion held by Singapore while the Philippines held US\$13 billion. By 2004, Japan's foreign reserves would rise to US\$820 billion while China's would total US\$500 billion. By this time, Korea's reserves had climbed to US\$174 billion, and Korea too had emerged as a key lending country in the CMI (see Table 4). The distribution of international reserves among the East Asian states explains why the CMI could never have been adopted under the auspices of ASEAN alone. (see Table 5).

⁹² Amyx (2005) p. 3.

Table 5: Foreign Exchange Reserve Holdings of East Asian Countries (US\$ billion)

Country/Region	1995	2000	2002	2004
Japan	183.3	354.9	461.2	820.8
China	75.4	168.3	291.1	500.6
South Korea	32.7	96.1	121.3	174.4
Hong Kong	55.4	107.5	111.9	118.2
Singapore	68.7	80.1	82.0	101.1
Indonesia	13.7	28.5	31.0	35.0
Malaysia	23.8	29.5	34.2	54.2
Philippines	6.4	13.0	13.1	12.7
Thailand	36.0	32.0	38.0	43.7
East Asian-9	495.2	910.1	1,183.9	1,860.7
World Total	932.5	2,028.8	2,525.1	3,517.0

Source: Kawai and Motonishi (2004: 223)

Although China and Japan are historic rivals, Sino-Japanese rivalry has yet to derail cooperation on the CMI. If anything, their rivalry has perhaps facilitated advances on the CMI as each government tries to compete with the other in establishing its leadership credentials in the region.⁹³ Interestingly, the May 2005 decision to advance the CMI was reached during a time when relations between the two countries were at their lowest in three decades with violent anti-Japan protests erupting in parts of China, especially in the capital. As Japanese finance minister, Sadakazu Tanigaki noted, ‘whatever happens, we need to promote financial cooperation even if there are [political] issues.’⁹⁴

If, however, China is unwilling to ‘play second fiddle to Japan in any regional organisation in East Asia, as some scholars claim,⁹⁵ how Japan responds to an assertive China will be key to the future of regional financial cooperation. A Philippine academic observed that some members of the Japanese intelligentsia – notably a former Vice-Minister of Finance –

⁹³ Author’s interview with a senior official from the Singapore Monetary Authority, October 2005.

⁹⁴ *The Straits Times*, ‘Three Asian giants join forces to fight currency attacks’, 5 May 2005.

⁹⁵ Wang (2002) p. 14.

supported the idea that China should take the lead in regional economic integration and financial cooperation in East Asia.⁹⁶ However, the resounding victory for Japanese Prime Minister Junichiro Koizumi in September 2005 could influence official Japan's position on such matters. Koizumi also follows an ardently pro-U.S. line, which has led to policy moves in the past few years that have upset Beijing.⁹⁷ Moreover, Koizumi's regular visits to the controversial Yasukuni Shrine where a number of war criminals are buried never fails to spark official and public anger in Beijing, the most recent in October 2005. How these dynamics will affect the workings of APT financial cooperation remains to be seen.

Although Sino-Japanese rivalry has not derailed APT financial cooperation as already noted, it does contribute to a sense of uncertainty that regional financial cooperation could stalemate in the future. Nevertheless, other observers point out that such kinds of functional cooperation take place at the trans-governmental level among officials of central banks and finance ministries who have maintained good working relations over a period of time and share common goals with respect to regional financial cooperation.⁹⁸ In such circumstances, political differences and historic rivalries are less likely to disrupt APT cooperation in finance that largely involves technocrats and where the economic benefits of such a project are clearly perceived by all parties. In contrast, differences between Japan and China over the membership of the East Asian Summit (EAS) held in December 2005 in Kuala Lumpur could well impede attempts to put in place any institutional framework for an 'East Asian community,' especially if its

⁹⁶ Author's interview in Manila, September 14, 2005.

⁹⁷ Lu (2005)

⁹⁸ Author's interview with a senior ADB official in Singapore, November 11, 2005.

economic gains are poorly defined such that inter-state rivalries and political differences are able to overwhelm the project.⁹⁹

IV. IMPLICATIONS OF SOUTHEAST ASIA'S NEW INSTITUTIONAL ARRANGEMENTS

What are the implications of this rather bewildering array of new institutional arrangements that the Southeast Asian countries have put together to govern their trade and financial relations since the 1990s? From the preceding discussion, it would appear that the emerging regional economic architecture is characterised by the following features:

- (a) economic integration undertaken at the ASEAN level;
- (b) financial cooperation undertaken at the APT level;
- (c) a slew of bilateral economic arrangements, ranging from those at the ASEAN +1 level, and between individual ASEAN member countries with one or another of the Northeast Asian states or with outside third parties;
- (d) an emerging institution centred on a distinct *East Asian* rather than an APT configuration; and
- (e) A trans-Pacific institutional arrangements centred on APEC.

How do we interpret these trends, and what are their implications for both the regional and world political economies?

One key point to note is that both the ASEAN and APT institutional levels remain important, they fulfil distinct economic functions and should not be seen in zero-sum terms as competing institutions. While ASEAN economic integration remains vital to its members as an instrument to ensure regional economies remain attractive to global investment capital,

⁹⁹ *The Daily Yomiuri*, 'Japan, China clash over East Asian Summit', 25 November 2005

especially in competition with China, the APT is the most logical level at which to develop a regional liquidity mechanism given the vast financial resources available in the Northeast Asian countries and the unattractiveness of APEC as a setting for such a project. APT also supports efforts in regional bond market development, which can help to channel the region's considerable savings for use within the region. In the case of ASEAN economic integration, the geographically concentrated nature of this arrangement is important because the aim is to create a regional market not only in terms of size (GDP, population) but also in terms of a geographically contiguous space in which regionalised production networks may be located and that take advantage of the range of economic complementarities existing within that geographic space.¹⁰⁰ Apart from financial cooperation, the APT has yet to see concrete progress in other areas earmarked for cooperation. Negotiating an APT-wide free trade area, as some have suggested, will be a formidable task given different levels of development, diverse special interest groups, and other political sensitivities. The divisions that will hinder an APT-wide free trade area, in fact, reflect the same divisions in the WTO over agriculture and investment that have stalemated global trade talks since the Seattle debacle.¹⁰¹ As already noted, stalemate at the WTO is one reason why bilateral FTAs have mushroomed in the region.

Bilateral FTAs cannot, however, replace ASEAN-wide liberalisation given the reality of transnational production networks spread out across ASEAN. The setbacks encountered in trade liberalisation notwithstanding, all the ASEAN governments accept that regional integration enables small economies to better position themselves to attract global investment. Progress thus

¹⁰⁰ New flexible production technologies involve agglomeration as well as decentralisation (or expansionary) logics, thereby making geographically concentrated institutional arrangements salient features of the world political economy. See Dicken (1998) pp. 216-17).

¹⁰¹ Desker (2004) p. 16.

far may be slow, but perceptions of China soaking up investment could well act as a fillip to the integration process. ASEAN, moreover, engages in a much broader economic cooperation agenda, including social development projects that help support regional liberalisation. Aside from its economic agenda, ASEAN is engaged in a wide range of cooperative tasks in the political, security, and environmental arenas. The ASEAN region sees a range of transnational cross-border security problems ranging from illegal migration, environmental spillovers, infectious diseases, smuggling of drugs and people, and terrorism that require ASEAN-wide collective efforts. Thus, both ASEAN and the APT will remain equally salient as institutions meeting Southeast Asia's economic and strategic/security needs.

Prospects for the formation of an East Asian community remain somewhat dim notwithstanding Malaysia's hosting of the first East Asian Summit (EAS) in December 2005. Membership proved problematic before the Summit, while many invitees remained unclear as to the agenda for the meeting although some suggestions on economic and development cooperation had been put forward a year earlier.¹⁰² Although the Summit itself went smoothly, it is likely that an East Asian Community will take some time to evolve into something more concrete, given especially the diversity of its potential membership (all the ASEAN-10, the three Northeast Asian states, India, Australia and New Zealand) and the deep rivalries between some of these members that led to problems when drafting a joint declaration to be tabled by leaders at the Summit.¹⁰³ The major point of contention was over the form of a future East Asian Community, with China and some ASEAN countries eager for East Asian regionalism to be built on the APT while Japan prefers the broader EAS to be the basis of any future East Asian

¹⁰² *New Straits Times*, 'Abdullah spells out milestones for EAC', 9 December 2004.

¹⁰³ *The Daily Yomiuri*, 'Japan, China clash over East Asian summit', 25 November 2005.

Community in order to counterbalance China by the presence of India and Australia. These difficulties suggest that even if held regularly, the EAS will likely end up as a dialogue mechanism for its current 16 participants for the foreseeable future while more substantive areas of cooperation, such as financial cooperation, will be continued under the APT framework.

As for their implications for the world economy, both ASEAN economic integration and APT financial cooperation, the central planks in the emerging regional economic architecture, are supportive of rather than detrimental to the global economy. These institutional arrangements were instituted primarily to enhance the ability of member economies to participate in the global economy while minimising the risks of doing so. Moreover, the rules that are being put in place in both these projects are essentially liberal rules and endorse open markets, with regional financial cooperation retaining links with multilateral institutions like the IMF. However, regional financial cooperation does have the long-term potential to reduce the dominance of the IMF. Even if the IMF remains part of an expanded CMI, the fact that a viable regional financing facility exists will erode the overwhelming influence of the IMF in the region.

It is the bilateral trend that is more threatening to global institutions like the WTO as well as to regional economic cooperation. The bilateral instrument also undermines business efficiency as it is institutionally incongruent with the regional production networks that are now emerging across the region. This raises transaction costs for firms, especially with each bilateral arrangement imposing its own rules of origin, which makes it difficult for firms already sourcing inputs from more than one country. This is why in the U.S.-Singapore Free Trade Area, a provision called the Integrated Sourcing Initiative has been included to extend the juridical reach of the free trade area to include two Indonesian islands, Batam and Bintan for the category of electronics and information technology items. Because production of final goods in this

crucial sector in Singapore involves extensive use of components produced on Bintan and Batam islands, strict rules of origin under the bilateral FTA would effectively exclude Singapore-made final products from the U.S. market unless crucial portions of Singapore's production space that extend outside Singapore are included within the ambit of the bilateral agreement.

V. CONCLUSION

This paper has shown how the Southeast Asian states adopted a variety of new institutional arrangements in response to a range of external pressures, with the specific institutional mechanism adopted reflecting their international position, the specific nature of the collective good sought and the prevailing institutional context. While the end of the Cold War precipitated the establishment of APEC, structural economic shifts in the global economy generated perceptions of an FDI crisis that prompted ASEAN economic cooperation through AFTA. The Asian financial crisis stimulated Southeast Asia's interest in developing self-help capabilities in responding to similar crises in the future and prompted the consolidation of regional financial cooperation through the APT. The September 11 terrorist attacks have had little effect on new economic arrangements in Southeast Asia, although the War on Terrorism seems to have taken APEC away from a purely economic role.

Institutional arrangements such as ASEAN and the APT are now central to the regional economic and broader political order, while APEC has declined in importance. The APT, as with the ACFTA, has the potential to elevate China to a significant leadership position in the evolving regional order. China has, of late, displayed a benign form of economic leadership in the region, as discussed above, matched also by its political and security engagements with countries like Indonesia, Malaysia and the Philippines. These factors have led ASEAN to cooperate more

closely with China despite China's position as its major economic competitor. On the other hand, Washington's Enterprise for ASEAN Initiative (EIA) by which the U.S. negotiates FTAs with individual ASEAN states could enhance the position of the U.S. in the regional economic order by entrenching it as the economic hub with the spokes represented by individual ASEAN states. However, apart from the FTA already concluded with Singapore, bilateral FTA negotiations between the U.S. and its ASEAN counterparts will face considerable difficulties. Thai-U.S. negotiations have faced setbacks over U.S. demands to liberalise financial services in Thailand. Although Malaysia has signed a framework agreement that sets the stage for formal FTA negotiations with Washington, Malaysia's insistence on excluding government procurement could derail formal negotiations once they begin and if U.S. businesses lobby their negotiators to include what is a crucial sector for American firms.

The different interests and rivalries involving the U.S., Japan and China, the major powers impinging on Southeast Asia, in fact, opens up space for ASEAN to play a more central role in steering regional economic institutions as it has in the past. With the range of interests, issues and rivalries expected to increase with India and Australia included in the East Asian Summit, the window of opportunity for ASEAN to claim such a role will only increase. Already, ASEAN has assumed the role of driver for this process, with future Summits to be chaired by an ASEAN member and scheduled to be held following the ASEAN Summits.¹⁰⁴ Where ASEAN lacks the resources and capabilities to undertake such efforts on its own, it will pragmatically engage with other parties to construct institutions that help provide economic and other benefits to its members. The APT framework for financial cooperation illustrates this dynamic very well. Despite the growing variety of institutional arrangements to govern Southeast Asia's economic

¹⁰⁴ ASEAN (2005).

relations, ASEAN-based institutions including the APT are likely, therefore, to maintain a central role in the regional economic architecture.

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